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FARM CREDIT ADMINISTRATION  
Washington, D. C.

SUMMARY OF CASES  
RELATING TO  
FARMERS' COOPERATIVE ASSOCIATIONS

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Prepared under the direction of  
L. S. Hulbert  
Assistant General Counsel  
Farm Credit Administration

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COOPERATIVE RESEARCH AND SERVICE DIVISION



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PRICING SYSTEM INVOLVING  
COUNTY FARM BUREAUS CONDEMNED UNDER  
ROBINSON-PATMAN ACT

A certain manufacturer of legume inoculants distributed its products through jobbers and dealers under a system of pricing whereby customers were classified as jobbers, retail dealers, and consumers. The price lists established separate prices for each class of customer, and in case of sales of larger quantities, lower prices were accorded each class of customer. However, very few of the distributors functioned in one capacity only, and most jobbers sold to consumers as well as to dealers. The manufacturers sold a large portion of their products through farm bureaus, which sold the inoculants to farmers and occasionally to local elevators and other dealers.

A picture of the competitive price structure is contained in the following quotation, taken from the findings of facts of the Federal Trade Commission, In the Matter of Albert L. and Lucille D. Whiting, trading under the firm name and style of "The Urbana Laboratories," Respondents, decided on January 12, 1938 (Docket 3265):

"Prices to certain county farm bureaus vary and are frequently as low as 17¢ for the one bushel size which is sold to many dealers for 30¢ and to a number for 20¢. County farm bureaus retail the one bushel size frequently at a lower price than small independent merchants, having purchased the one bushel size at from 17¢ to 20¢ or the 2½ bushel size at from 34¢ to 40¢. A typical competitive situation disclosed one dealer selling at 50¢ and purchasing the one bushel size at 30¢. A competing dealer likewise sold at 50¢ and likewise purchased at 30¢ but had the postage paid. Another dealer, competing with the first-named, sells at 40¢ but buys at 20¢ and states that his lower price is made to meet competition created by the county farm bureau. Many county farm bureaus sell to non-members also. These county farm bureaus are direct competitors of independent retail merchants buying at higher prices. Where, in fact, jobbing services are rendered by State or county farm bureaus, nothing herein contained shall preclude jobber prices on that portion which is jobbed." (Underscoring added.)

The Commission held that the difference in prices resulting from the classification in effect constituted a discrimination in price in commerce, both as to those customers of the manufacturer who were competitively engaged in reselling the products to consumers and as to those customers who were engaged in reselling the products to dealers; and that the difference in prices did not make "only due allowance for differences in the cost of manufacture, sale or delivery resulting from the differing methods or quantities in which such commodity is to such purchasers sold or delivered," and "that such

price differentials were not in response to changing conditions affecting the market for or the marketability of the goods concerned."

The order is of particular significance in that it holds, in effect, that a jobber (including a farm bureau) is entitled to jobbers' prices only on those goods which are distributed to dealers, and that the jobber should be required to pay the same purchase prices as a dealer on all goods sold to consumers. The Commission further found that "The costs of growing, selling and delivery are generally not substantially affected by quantity purchases, largely due to the practice of accepting the return of goods unsold, which returned goods are then practically valueless," and that "The discriminations in price set forth above do not make only due allowance for differences in the cost of manufacture, sale or delivery resulting from the differing methods or quantities in which such commodity is to such purchasers sold or delivered. That such price differentials were not in response to changing conditions affecting the market for or the marketability of the goods concerned."

Finally, it should be observed that farmers organizations are accorded the same treatment as others engaged in performing a similar business function. For other cases decided by the Federal Trade Commission, in which similar conclusions were reached, see: In the Matter of Agricultural Laboratories, Inc., January 12, 1938, Docket No. 3263; In the Matter of Hansen Inoculator Company, Inc., January 12, 1938, Docket No. 3264; In the Matter of The Nitragin Company, Inc., January 12, 1938, Document No. 3266.

Attention is also called to the case of Oliver Brothers, Inc. et al. v. Federal Trade Commission, 102 F. (2d), 763, involving the question of whether, under the Robinson-Patman Act, a purchasing agent, acting on behalf of buyers, could pass on to them brokerage commissions received by him from sellers. In answering the question in the negative, the court said, in part:

"It is argued that the act was directed at the practices of chain stores in using the force of great buying power to obtain these concessions from the seller. It is sufficient answer that the Act makes no distinction as to size and shows no intention to give the small any more than the great the right to receive brokerage commissions on their purchases. Because of the buying power possessed by purchasing agents, whether representing chain or independent dealers, sellers may be willing to allow them brokerage commissions, and may consider such commissions earned in the sense that the sellers are thus enabled to sell goods without resorting to other sales devices; but the fact remains that the buyer who receives the brokerage allowed his purchasing agent receives an advantage, and a concealed advantage, which the buyer who purchases directly from the dealer does not receive. It was this sort of discrimination,

we think, which it was the purpose of this section of the Act to forbid."

See also Biddle Purchasing Company v. Federal Trade Commission, 96 F. (2d) 687, certiorari denied 59 S. C. 101, in which a similar conclusion was reached.

ARE PACKING HOUSE EMPLOYEES  
OF A  
COOPERATIVE MARKETING ASSOCIATION AGRICULTURAL LABORERS?

Are the packing house employees of a cooperative marketing association agricultural laborers? The National Labor Relations Board has answered this question in the negative.

An association was charged with unfair labor practices in connection with the discharge of certain employees and failure to reinstate, subsequent to a lay-off, certain employees, who had engaged in union activities; and with interfering, restraining, and coercing its employees in the exercise of rights guaranteed by the National Labor Relations Act.

The association was engaged in the marketing of citrus fruits and employed certain field laborers for fumigating, spraying, and dusting the citrus fruit groves of its members and in picking the fruit, and also employed a regular force in its packing house for washing, grading, and packing the fruit for shipment and marketing. The field laborers were not involved in the case, which was concerned only with the status of the packing house employees.

The association contended that the packing house employees were exempted from the National Labor Relations Act under section 2(3) of the act as agricultural laborers and that the National Labor Relations Board was without jurisdiction. A number of factual defenses not germane to the question of whether packing house employees of a cooperative are agricultural laborers were introduced in the trial of the case.

In support of its views, the association argued that the customary and accepted meaning of the term "agricultural laborer" in the California citrus business included graders, pickers, and floor laborers employed in packing houses. While the association introduced general testimony on this point, it appears that the Unemployment Reserves Commission of California had adopted a contrary definition and did not regard such employees as agricultural laborers.

The association also attempted to establish that it was customary in the industry to interchange labor between the packing houses and the field activities, but the evidence failed to sustain this position. It appeared that only on rare occasions, and then for a

few days only, were any of the packing house employees engaged in field work. It was also shown that the association operated for a period of about 8 months in each year and in the off season, its employees worked at odd jobs for others in a number of different industries not confined to agriculture.

The association also was unsuccessful in attempting to establish the fact that historically packing house employees were agricultural laborers. The board pointed out that this argument failed to take into account the vast changes which had taken place in packing house operations and the mechanized character of present day processes. The contention that since the association functioned on an agency basis that the fruit remained the property of the grower, and, therefore, the packing house employees were really the employees of the grower was rejected. In this connection, "the respondent (association) adduced proof that the identity of the fruit belonging to the individual grower is not lost throughout the packing house operations. The respondent argued that on the basis of this fact it must be considered the agent of the orchard owner, and the workers which it employs must be considered agricultural laborers because they are in effect in the same position as packing workers employed directly by the orchard owner. The facts of this case do not require that we concede that packing workers employed directly by the orchard owner are agricultural laborers. Since the reasoning of the respondent presupposes that employees of an agent must be considered employees of the principal, the argument is without merit. Furthermore, it is doubtful whether the affiliated orchard owner has been content merely to name the local association as his agent. The record discloses that far greater powers have been conferred upon the cooperative marketing association, despite the terminology of agency which is used in the corporate documents."

Finally, it was shown, by appropriate citations and quotations, that packing house employees are not "agricultural laborers" as defined by the United States Treasury Department, Bureau of Internal Revenue, and the Social Security Board, the California Unemployment Reserve Law, and the United States Bureau of the Census; and that in the Fair Labor Standards Act of 1938, packing house employees are not regarded as agricultural laborers but are accorded special treatment as members of a particular group.

[In the matter of North Whittier Heights Citrus Growers' Association and Citrus Packing House Workers Union Local No. 21091, Case No. C-310, Decision and Order of the National Labor Relations Board, March 21, 1938, on first hearing. Remanded without opinion for further proceedings 97 F. (2d) 1010. Certiorari denied without opinion 59 S. C. 361. Decision and Order of National Labor Relations Board, January 19, 1939, Case No. C-310, following second hearing. A petition for review has been filed by the association with the United States Circuit Court of Appeals for the Ninth Circuit.]

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U. S. DEPARTMENT OF LABOR  
WAGE AND HOUR DIVISION  
WASHINGTON

POSITION OF COOPERATIVES UNDER THE WAGE AND HOUR ACT

The Fair Labor Standards Act provides no express exemption for cooperatives as such, Administrator Elmer F. Andrews of the Wage and Hour Division, U.S. Department of Labor, pointed out today. Many requests have been received by the Wage and Hour Administrator for information regarding the status of employees of cooperatives, many of whom own stock in the enterprise by which they are employed. Mr. Andrews in his statement discussed the relationships existing between these employees and the organization which employs them, of which they may be part owners.

The Administrator's statement follows:

"The question has been asked whether cooperatives are employers and members who work for them employees within the terms of the Fair Labor Standards Act. The term cooperative is used to describe various types of business organizations differing in form and method of operation. Accordingly, no statement can be made to cover all types of organizations calling themselves cooperatives. However, it may be said generally that no justification can be found for concluding that member-workers of cooperatives, otherwise covered, are not entitled to the benefits of the Act.

"Any doubt which exists must be based on the notion that cooperatives are, in effect, partnerships and that no employer-employee relationship exists between them and the members who work for them. Although it is possible that there may be 'workers' cooperatives in which the interests of the members as workers are in all respects the same as their interests as proprietors and in which the usual characteristics of the employer-employee relationship do not exist, and hence in which the worker-members would not be employees within the meaning of the Act it is to be noted that cooperatives are commonly separate entities in which the usual characteristics of the employer-employee relationship exist as between them and worker-members. Cooperatives are generally in the corporate form with interests distinct from those of their members. Though their workers may be stockholders, as workers they are subject to the usual control and discipline of the corporate employer; they work at the discretion of the cooperative's board of directors or other managerial body. Their concern, as workers, with wages, hours

of work and other working conditions, is quite distinct from and may be much greater than their interest, as stockholders, in profits or dividends.

"The Fair Labor Standards Act provides no express exemption in favor of cooperatives as do some other statutes and the provisions in the Act defining the employer-employee relationship cover the relation of the ordinary cooperative to its workers regardless of whether or not they are stockholders or members."

(281)

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U. S. DEPARTMENT OF LABOR  
WAGE AND HOUR DIVISION  
Washington

INTERPRETATIVE BULLETIN

NO. 10

FARMERS' COOPERATIVE ASSOCIATIONS  
UNDER THE FAIR LABOR STANDARDS ACT OF 1938

(1) Employees of cooperative associations, the members or stockholders of which are farmers, are granted no express exemption from the provisions of the Fair Labor Standards Act. Section 13(a)(6), however, exempts from both the wage and hour provisions of the Act any employee employed in "agriculture", which is defined in Section 3(f) as including "farming in all its branches and among other things includes the cultivation and tillage of the soil, dairying, the production, cultivation, growing, and harvesting of any agricultural or horticultural commodities (including commodities defined as agricultural commodities in Section 15(g) of the Agricultural Marketing Act, as amended), the raising of livestock, bees, fur-bearing animals or poultry, and any practices (including any forestry or lumbering operations) performed by a farmer or on a farm as an incident to or in conjunction with such farming operations, including preparation for market, delivery to storage or to market or to carriers for transportation to market." This bulletin will address itself to the question which has been raised most often by the inquiries received from farmers' cooperative associations: are the employees employed by such associations, solely because of that fact, engaged in " . . . practices (including any forestry or lumbering operations) performed by a farmer . . . as an incident to or in conjunction with" farming operations and therefore exempt? In other words, is a farmers' cooperative a "farmer" within the meaning of

(838)

Section 3(f)? This bulletin is merely intended to indicate the construction of the Act on this question which will guide the Administrator in the performance of his administrative duties.

(2) The phrase "by a farmer" was intended to cover practices performed either by the farmer himself or by the farmer through his employees. Employees of a farmers' cooperative, however, are employed not by the individual farmers who compose its membership or who are its stockholders, but by the cooperative association itself. Cooperative associations, whether in the corporate form or not, are distinct, separate entities from the farmers who own or compose them. The work performed by a farmers' cooperative association is not work performed by a farmer but for farmers. The legislative history of the Act supports this interpretation. Statutes usually exempt farmers' cooperative associations in express terms if an exemption is intended. The omission of an express exemption from the Fair Labor Standards Act is significant since many unsuccessful attempts were made on the floor of Congress to secure special treatment for such cooperatives. Employees of a farmers' cooperative association, therefore, in our opinion, are not engaged in "any practices . . . performed by a farmer . . ." within the meaning of Section 3(f) and are not exempt on the basis of this part of the definition of "agriculture" from the wage and hour provisions of the Act.

(3) This does not mean that all employees of farmers' cooperative associations are subject to the provisions of the Act. If, for example, they, like the employees of any other employer, are engaged in any of the operations or practices set forth in Sections 3(f), 7(c) or 13(a)(10), the exemptions provided in these sections apply. See, for example, Interpretative Bulletin No. 7 dealing with forestry or lumbering operations. An interpretative bulletin dealing with these various agricultural exemptions will be issued as soon as possible. Moreover, to be subject to the provisions of the Act, employees of farmers' cooperative associations like other employees, must be engaged in interstate commerce or in the production of goods for interstate commerce. See Interpretative Bulletins Nos. 1 and 5.

(838)

#### COOPERATIVE DENIED REFUND OF INCOME TAXES

In *Farmers Cooperative Company of Wahoo, Nebraska v. United States*, 23 F. Sup. 123, a cooperative association brought suit against the United States in the Court of Claims for refund of income taxes paid for the years 1923 through 1928. The cooperative contended that it was exempt as a cooperative from the payment of income taxes; and it was agreed that if the plaintiff was not entitled to exemption as a cooperative association, its taxes had been correctly determined by the Commissioner of Internal Revenue.

The Court stated that:

"Under the by-laws in force during the years involved herein, in order to become a member or stockholder, one must be a farmer, retired farmer, or a person approved by the board of directors, and the owner of at least one share of stock. No person was entitled to any interest, dividends, or profits except a stockholder.

"The by-laws further provide that at the close of each year's business, after the expenses of doing business have been paid, an allowance for depreciation shall be made and an amount equal to 5 per cent. of the capital stock shall be carried into a reserve for contingencies and then a dividend not to exceed 8 per cent. on the capital stock shall be paid to the stockholders; that, after the above distributions, the company shall set aside not less than 5 per cent. of the earnings or savings as a surplus fund to be used in conducting the business, and any remaining savings are to be distributed as a patronage dividend among the stockholder patrons on the basis of the amount of business done by each.

"Business was done with both members and nonmembers upon the same basis, i. e., plaintiff marketed the farm products of producers, advancing to all alike the estimated market value of such products, less a margin estimated to take care of the expenses of the sale thereof; and sold supplies and equipment on the basis of the cost thereof, plus freight and the estimated cost of handling same. The books of plaintiff were closed at the end of each year, showing the accumulation of savings resulting from overestimating the aforesaid costs of doing business."

Thirty percent of its business was done with nonmembers and a substantial portion of the nonmember business was transacted with those who were ineligible for membership in the association. No patronage dividends were paid during the period under review but profits were accumulated and used to retire indebtedness and credited to a reserve for contingencies and a surplus fund. Subsequent to the tax years here involved, the association amended its bylaws so as to provide for patronage dividends to members and nonmembers alike.

In upholding the tax assessments, the court said, in part:

"Counsel for defendant make their main objection to plaintiff's claim for exemption on the ground that nonmembers did not participate in the savings resulting from the business done with them on the basis either of the quantity or the value of the products furnished, or supplies purchased by them, as required by the statute; nor were such supplies turned over to them at actual cost plus necessary expenses. It is not claimed that the fact that plaintiff paid interest dividends to its

stockholders, or that it accumulated a reserve for contingencies or other necessary purposes, would subject the plaintiff to tax if it complied with the other conditions necessary to entitle it to exemption under the law, but the Treasury Regulations provide in article 532 of Regulations 74 that: 'If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the Act and is not exempt.'

"This regulation applies to all the years involved in the case and we think it is a fair construction of the law. If the regulation is valid, when transactions are had with or for nonmembers, the profits therefrom, less necessary operating expenses, must be returned to such patrons if the organization is to be exempt. We think the evidence shows plainly that the plaintiff did not comply either with the regulation or the statute.

"(1) During the period involved in the case, approximately 30 per cent. of all business transacted was with nonmembers, and it may be assumed that a corresponding portion of the profit realized by plaintiff in the operation of its business was obtained therefrom. During the period involved, after paying all expenses of running the business, providing for depreciation, and paying 8 per cent. interest on the capital stock, the profits realized by plaintiff were sufficient to build up a surplus at the end of 1928 of \$16,248.43 and, in addition, a contingency reserve of \$16,715, a total of \$32,963.43, or more than half of the par value of its outstanding capital stock. During this period the plaintiff's by-laws restricted the right to receive any interest, dividends, or profits to its stockholders. In fact, under the by-laws which were in force at this time, there was no way in which nonmembers could acquire an interest in the surplus and reserve which had been created. Besides this, it appears that no account or credit was ever set up on the books with reference to patronage dividends attributable to the business done with nonmembers, and there was no basis upon which they could make a legal claim to share in the profits of the business which had been done with them. It is clear therefore that plaintiff did not comply with the condition of tax exemption, namely, that the association shall be organized and operated for the purpose of turning back to the 'members or other producers' the profits or savings on the basis of the quantity or value of the business done with each of such persons.

"The Board of Tax Appeals has held in many cases that there must be an equality of the treatment of members and nonmembers in order to make the association exempt, and there are a number of decisions to the same effect by the federal courts.

Counsel for plaintiff contend that some of these cases involve different facts, but the rules and principles laid down by the courts apply to the case at bar."

The association also unsuccessfully contended that since it was a cooperative association meeting the requirements of the State of Nebraska, it was necessarily exempt from taxation.

In *Farmers Union Cooperative Supply Company of Stanton, Nebraska v. United States*, 23 F. Supp. 128, a case involving a similar set of facts and which was submitted at the same time, a similar conclusion was reached.

MAY A COOPERATIVE ASSOCIATION BE PARTIALLY  
EXEMPT FROM INCOME TAX?

May a cooperative association be partially exempt from income tax? While some basis for the view that a cooperative association may be subject to taxation on a part of its business and yet exempt from taxation as to the remainder of its business may be found in *Eugene Fruit Growers Association v. Commissioner of Internal Revenue*, 37 B. T. A. 993, which involved unusual facts and circumstances, it would seem that fundamentally there is no such thing as partial exemption from income taxes.

In the Eugene case, the Commissioner had determined a deficiency in income taxes for the year 1933 against the association, based upon the alleged taxability of two items, one consisting of \$3,062.28 which the association had retained in that year out of the 1930 carrot pool and had credited to the building fund reserve, and the other item of \$5,948.10, consisting of deductions from the proceeds of other pools, which was used for the payment of a three percent dividend. Both deductions were apparently authorized by the bylaws and marketing agreements.

The association claimed, first, that it was an exempt cooperative association as to its marketing business, which was conducted on a strictly cooperative basis, and second, that the items in question, even if the association were subject to taxation, did not constitute taxable income.

The association had filed an income tax return and had paid taxes on certain business operations which it did not claim were cooperatively conducted. With respect to the scope of the association's activities, the Board said:

"In addition to the processing and marketing of members' products on a nonprofit basis, petitioner also conducts 'commercial departments', which apparently engage in certain other activities. These departments operate a refrigeration plant

selling ice and ice cream, maintain a machine shop in which some custom work is done, manufacture vinegar, beverages, and certain 'specialties' such as pectin, mayonnaise, salad spreads, pickles, jams, jellies, and juices, and handle certain supplies such as sprays and fertilizers. Besides this, they take over from the producers 'pools' inventories of canned and processed products which have not been disposed of at the end of a reasonable period, 'paying' for these items on an estimated fair market basis and thus permitting the more expeditious liquidation of the pools themselves. The products so acquired are disposed of by this department as occasion permits.

"The last item is by far the largest in dollar volume. It accounts for \$102,409.61 out of total gross sales of all the 'commercial departments' of \$236,572.42. It may be questioned whether this item is essentially different from the sales made out of the pools themselves, since sales of the same products are made to the same market. Though referred to as a 'sale' by the pools, the transfer to the 'commercial department' is nothing so imposing, since title to the products is in the association from the beginning. The distinction is principally one of bookkeeping. Sales out of the pools are prorated among the producers in the pool and the proceeds of these sales are distributed only after the sales have been made and the inventory exhausted, there being first deducted an amount later used for payment of dividends. Products not so disposed of, and taken over to be sold by the 'commercial department', return a payment to the producers immediately, but this is an estimate of what they would have brought had they been sold from the pool, namely, estimated market price less estimated cost of marketing. Only if these estimates prove erroneous can there be any 'profit.' And this 'profit', even if it results, is not essentially different from the dividends paid out of pool operations. It goes almost entirely to the producer-members in any event, though not as participants in the operation of the pools but as stockholders. This single factor, however, can not be sufficient to condemn petitioner's plan of operation, since the payment of dividends up to 8 percent is expressly permitted by the revenue act, and petitioner is not authorized to exceed this figure. Petitioner's practice appears to be an appropriate method of solving one of its operating problems and we should be reluctant to conclude that it would thereby become disqualified for exemption."

The association also sold merchandise and supplies, to a certain extent, for the convenience of the growers, and sold them to some nonmembers upon a commercial basis. As has already been stated, the association had paid an income tax upon all of these so-called commercial transactions.

Concerning the so-called commercial activities, generally, the Board stated:

"It seems to us that all of the activities mentioned originated and were continuously maintained as incidents of the association's principal function, cooperative marketing for agricultural producers. They were, according to the uncontroverted evidence, designed to assist in the efficient performance of that function by facilitating the marketing of products, on the one hand, and by reducing the cost of necessary operations, on the other. The encouragement extended to such enterprises by the favorable provisions of the revenue acts would to say the least be anomalous if the sacrifice of efficient operations were to be required in order to attain the statutory exemption. We find no justification for such a construction of the law or of the regulations.

\* \* \* \* \*

"Looked upon as a whole it seems to us that these 'commercial departments' were purely incidental to petitioner's principal purpose. They were conducted, not for their own sake, but as an adjunct and supplement to the cooperative marketing of farm products. See Producers' Produce Co. v. Crooks, 2 Fed. Supp. 969. This seems to us to be the test, and not the numerical percentage of petitioner's business attributable to those branches. It may be that the proportion of business done could be so great that it would be unreal to consider such operations incidental. Cf. Hills Mercantile Co., 22 B. T.A. 114. On this point we need express no opinion, since in our view no such contention could prevail on the facts before us."

The comments of the Board of Tax Appeals on the subject of "partial exemption" follow:

"It is urged with great force on respondent's behalf that petitioner can not be both exempt and nonexempt and that if exempt there was no ground for the filing of any return or the payment of any tax as to any part of petitioner's income. That may be true, but whether true or not it raises no issue for our determination in this proceeding and we therefore refrain from deciding the question. If, on the one hand, it were possible for petitioner to be exempt as to part of its income and subject to tax as to the balance, there would be no question before us, since petitioner would then have made the return and paid the tax required. If, on the other hand, petitioner is exempt as to all of its income, including that part on which it has already paid the tax, there is nevertheless no question before us, since no claim of overpayment is made and petitioner specifically disclaims any attempt to litigate the necessity of filing a return or paying a tax as to its 'commercial income.'

Petitioner's counsel stated: 'No, we are not contending that the commercial department is free from taxation or is exempt. The only thing we are claiming is that the cooperative operations are exempt.' There being thus no basis in this contention for a different result on the issue before us, whichever way it might be decided, we refrain from discussing it further. See Central Co-Operative Oil Association, 32 B. T. A. 359."

It is submitted that the Board did not pass upon the question of whether an association might be exempt on some of its business and nonexempt on the remainder, but the actual result of the case was to hold that the association, which had admitted its taxability on the so-called commercial activities by the payment of taxes, was not required to pay income taxes on its cooperative marketing activities. This inconsistency is explainable on the ground that the taxability of the association on its commercial activities was not in issue before the Board. Just what position the Board of Tax Appeals would have taken if the taxability of the association on all of its business had been in issue is uncertain. However, the language of the opinion affords a considerable basis for the view that the Board regarded the association as exempt from taxation on all of its activities on the ground that the so-called commercial activities were incidental to its major operations and so insignificant as not to deprive the association of its right to exemption.

In the Eugene case, the Commissioner also contended that no provision had been made for participation by nonmember producers in the earnings of the association. The Board pointed out that this was immaterial, in view of the fact that the association did not do business with nonmembers, at least insofar as the marketing operations were concerned.

In *Farmers Union Cooperative Oil Company of Nelson, Nebraska v. Commissioner of Internal Revenue*, 38 B. T. A. 64, the Board of Tax Appeals, in commenting on the subject of partial exemption from taxation, said:

"In *Fruit Growers Supply Co. and Central Co-Operative Co.*, supra, the deficiencies determined by the Commissioner were based only on that part of petitioner's income which represented profits on sales to nonmembers and was not distributed to them. The Board in both cases upheld the Commissioner's determination, but the question of whether an association claiming exemption from income tax as a farmers' cooperative association could under the statute be partially exempt and partially not exempt was not presented to the Board in either of the cases. The decision in *Fruit Growers' Supply Co.* was cited as authority for the holding in *Central Co-Operative Oil Association*. In the report in the first case we said:

"What the Commissioner did was first to determine the petitioner's net income for each year in a manner similar to that which would be followed in the case of any taxable corporation. Since we have held that the petitioner is not an exempt corporation, his initial step in such a determination would seem to be a proper one. From the total net income as thus determined the Commissioner then allowed a further deduction of all patronage dividends which were applicable to the respective years and considered the difference between the total net income and the patronage dividends as taxable income. And if we understand clearly the amounts which have been allowed in this latter deduction, the effect was to give the petitioner the benefit as a deduction of all patronage dividends declared or paid during the years with which we are concerned. The essence of what the petitioner asks is to say that all surplus earnings for a given year which have not been paid out as such dividends by the end of such year automatically became patronage dividends accrued, without any action on the part of the petitioner declaring them as dividends, and that they are therefore deductible under its accrual system of accounting \* \* \*

We are unable to agree with the foregoing contention. In the first place, we find nothing in the governing statute which provides for a partial exemption from taxation of corporations of the character of the petitioner.

"In Eugene Fruit Growers' Association, 37 B. T. A. 993, petitioner was a cooperative marketing association and had marketing agreements only with fruit growers who were members of the association. Nonmembers did not participate in such operations. The only issue before the Board in that case was whether the cooperative operations were exempt. No claim of exemption as a cooperative purchasing association was made in that case." (Underscoring added.)

In view of these comments, as well as the express language of the Eugene case, it would seem that the Board of Tax Appeals regards the matter of exemption as one of entirety and does not entertain the view that an association may be exempt from taxation on part of its business and subject to taxation on the remainder.

In the Farmers Union Cooperative Oil Company case, the proceedings were brought for a redetermination of deficiencies in income and excess profit taxes for 1933, in which the petitioner, a purchasing association, claimed exemption from income taxes.

The association dealt with both members and nonmembers, and in addition sold petroleum products in large quantities on a nonprofit basis to three of its shareholders and four nonmember patrons. Patronage dividends were credited only to patrons of record, but only member patrons received payment of dividends. Nonmember patrons

eligible for membership were credited with the amount of patronage earnings on stock purchases upon becoming members of the association, but no patronage dividends were paid to ineligible nonmember patrons. In addition, there were a considerable number of unknown nonmember patrons to whom patronage dividends were neither credited nor paid.

In the opinion, the Board states that all of the following facts must be established, in order to confer on a cooperative association an exempt status:

"1. That it is a farmers', fruit growers', or like association organized and operated on a cooperative basis.

"2. That it was organized and operated for the purpose of purchasing supplies and equipment for the use of its members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses.

"3. That its stock dividend rate is fixed at not to exceed the legal rate of interest in the state of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued.

"4. That substantially all of the stock of petitioner was owned by producers who purchase their supplies and equipment through petitioner.

"5. That the supplies and equipment purchased for nonmembers do not exceed in value the value of like purchases for members.

"6. That the value of the purchases made for persons who are neither members nor producers does not exceed 15 percent of the value of all its purchases."

The Board held that the association was not entitled to an exempt status, for the reason that it was not operated on a cooperative basis, in that members and nonmember patrons were not accorded the same treatment, and in addition, three or four nonmember patrons were preferred over all other patrons, since the sales were made to them at actual cost, without adding any amounts to cover any expenses, stock dividends or reserves:

"Patronage dividends were paid or credited only to patrons of record to whom sales were made at regular retail prices, but only members received payment of such dividends. Nonmembers, even though credited therewith, did not receive payment of patronage dividends. A nonmember had to qualify for membership and pay \$10 for a share of petitioner's capital stock before he could receive payment of a patronage dividend credited

to him. Moreover, it affirmatively appears that there were a number of nonmember patrons to whom patronage dividends were credited who could never qualify as members, and, therefore, could never under any conditions receive payment of such dividends. It also affirmatively appears that there was a considerable though unascertainable number of unknown nonmember patrons to whom patronage dividends were not, and could not be, credited or paid.

\* \* \* \* \*

"The preferred group of patrons realized a saving which was tantamount to a bonus on their purchases, measured by the proportionate share of the necessary general expenses of petitioner which they would have been required to pay had they purchased on a basis of actual cost plus necessary expenses. Their share of the necessary expenses was paid by the other patrons. Not only did this preferred group contribute nothing to petitioner's profits or to defray its necessary expenses, but the three shareholders in that group received stock dividends out of petitioner's profits from sales to other patrons at regular retail prices. The evidence negatives the fact that petitioner was operated on a cooperative basis, either as among its members alone, or as between its members and nonmembers."

RIGHT OF NONEXEMPT ASSOCIATION TO DEDUCT  
PATRONAGE DIVIDENDS IN COMPUTING TAXABLE INCOME

The following is quoted from a publication of the Bureau of Internal Revenue (XVI-10-8579 G.C.M. 17895):

"So-called patronage dividends have long been recognized by the Bureau to be rebates on purchases made in the case of a cooperative purchasing organization, or an additional cost of goods sold in the case of a cooperative marketing organization, when paid with respect to purchases made by, or sales made for the account of the distributees. For the purposes of administration of the Federal income tax laws, such distributions have been treated as deductions in determining the taxable net income of the distributing cooperative organization. Such distributions, however, when made pursuant to a prior agreement between the cooperative organization and its patrons are more properly to be treated as exclusions from the gross income of the cooperative organization. (I. T. 1499, C. B. 1-2, 189; S. M. 2595, C. B. III-2, 238; G. C. M. 12393, C. B. XII-2, 398.) It follows, therefore, that such patronage dividends, rebates, or refunds due patrons of a cooperative organization are not profits of the cooperative organization, notwithstanding the

amount due such patrons can not be determined until after the closing of the books of the cooperative organization for a particular taxable period.

"In view of the foregoing, it is the opinion of this office that such patronage dividends may be excluded in determining the amount of the undistributed net income of the cooperative organization subject to the surtax imposed by section 14 of the Revenue Act of 1936, provided the liability therefor is set up on the books of the cooperative organization pursuant to corporate action taken with respect thereto prior to the close of the particular accounting period.

"This memorandum is applicable only to true cooperative organizations. The burden of proof is upon an organization to substantiate by competent evidence any contention it may make in that respect."

The underlying principle has been recognized in the case of a private corporation organized by commercial corporations for the purpose of effecting savings in the cost of printing.

In *Uniform Printing and Supply Company v. Commissioner of Internal Revenue*, 88 F. (2d) 75, all of the stock of the Company was owned by various insurance companies for which the Company did printing on the basis of estimated cost, plus 10 percent. The question before the court was the validity of an income tax assessment which had been levied by the Commissioner and sustained by the Board of Tax Appeals.

The bylaws of the Company provided:

"That the stock certificate shall provide that all of the surplus earnings not in the opinion of the Board of Directors required in the conduct and/or expansion of the business of the corporation shall each year be returned to the customers of the corporation in the proportion that the gross amount of business furnished by any customer bears to the gross amount of business done by the company, and the decision of the Board of Directors as to the percentage and/or amount to be returned to each customer shall be conclusive.

Concerning the application of this bylaw, the court stated:

"It was by virtue of this by-law that the \$128,943.46 was distributed to stockholders in December, 1930, and was entered on the petitioner's books as representing the net amount in excess of cost for that period which was subject to refund to customers, \* \* \* the amount having been determined by petitioner's accounting department as the excess over the actual

cost of operation for the year.' Petitioner listed in its income tax return this sum of \$128,943.46, but attached thereto the following statement, 'This corporation is a business league not organized for profit and all net earnings are turned over to the Uniform Committee for distribution to its stockholders.' The amount thus included was deducted as non-taxable income."

In reversing the order of the Board of Tax Appeals, the court said:

"Had the taxpayer given a customer (whether stockholder or outsider) a discount promptly after filling the order, no one would call it a dividend. If a rebate were given promptly upon the customer's business reaching a certain volume, the same conclusion as to its character would follow. To make cost estimates and adjust them at or near the end of each year returning the excess payment to the customer should not change the reasoning which leads to this conclusion. Nor should the fact that the customer is a stockholder materially affect the result.

"Perhaps a single refund coming at the end of each year would lessen the irresistibility of the inferences, but the conclusion would still fit the facts better than one founded on a dividend assumption. It is true the taxpayer is not a non-profit corporation in a legal sense. It is subject to a tax upon the profits by it made. Nevertheless, net profits in its case must depend upon the facts. Payment to the customers, who are also taxpayers, of sums called refunds based upon the volume of business transacted and in no way dependent upon stock ownership, is the determinative factor.

"Considering all the facts we conclude that the payments in issue were made as refunds rather than as dividends to stockholding customers."

An exempt association is not required to pay any income taxes or to file returns after its right to exemption has been established following its application for exemption. On the other hand, an association which is not exempt must compute its income taxes like any other taxpayer but if entitled to do so may deduct from its gross income payments made as patronage dividends.

In *Fruit Growers' Supply Company v. Commissioner of Internal Revenue*, 56 F. (2d) 90, the court stated:

"Until 'patronage dividends' are declared they have not accrued as obligations from the corporation to its members. We agree in this regard with the conclusions of the Board of Tax Appeals which we quote as follows: 'The petitioner now asks that we increase the patronage-dividend deduction on account of an

amount which has not been returned to the members and when no dividend declaration has been made with respect thereto. We find nothing in the petitioner's by-laws which would cause these patronage dividends to accrue as such without corporate action setting them apart as a liability of the petitioner to its members. The by-laws provide that it shall be the duty of the directors to 'declare dividends out of surplus profits when such profits shall, in the opinion of the directors, warrant the same, subject to the provisions' of another section wherein it is provided that the directors are authorized to prescribe 'the time and manner of readjustment with or refund to its patrons.' A reasonable interpretation of the foregoing would seem to be that corporate action is required before patronage dividends accrue, and this conclusion is consistent with the minutes of the board of directors for the various years here involved.'"

TABLE I		Summary of the results of the experiments on the effect of the concentration of the solution on the rate of the reaction	
Concentration of the solution (M)	Rate of the reaction (sec <sup>-1</sup> )	Concentration of the solution (M)	Rate of the reaction (sec <sup>-1</sup> )
0.01	0.001	0.02	0.002
0.02	0.002	0.03	0.003
0.03	0.003	0.04	0.004
0.04	0.004	0.05	0.005
0.05	0.005	0.06	0.006
0.06	0.006	0.07	0.007
0.07	0.007	0.08	0.008
0.08	0.008	0.09	0.009
0.09	0.009	0.10	0.010
0.10	0.010	0.11	0.011
0.11	0.011	0.12	0.012
0.12	0.012	0.13	0.013
0.13	0.013	0.14	0.014
0.14	0.014	0.15	0.015
0.15	0.015	0.16	0.016
0.16	0.016	0.17	0.017
0.17	0.017	0.18	0.018
0.18	0.018	0.19	0.019
0.19	0.019	0.20	0.020
0.20	0.020	0.21	0.021
0.21	0.021	0.22	0.022
0.22	0.022	0.23	0.023
0.23	0.023	0.24	0.024
0.24	0.024	0.25	0.025
0.25	0.025	0.26	0.026
0.26	0.026	0.27	0.027
0.27	0.027	0.28	0.028
0.28	0.028	0.29	0.029
0.29	0.029	0.30	0.030
0.30	0.030	0.31	0.031
0.31	0.031	0.32	0.032
0.32	0.032	0.33	0.033
0.33	0.033	0.34	0.034
0.34	0.034	0.35	0.035
0.35	0.035	0.36	0.036
0.36	0.036	0.37	0.037
0.37	0.037	0.38	0.038
0.38	0.038	0.39	0.039
0.39	0.039	0.40	0.040
0.40	0.040	0.41	0.041
0.41	0.041	0.42	0.042
0.42	0.042	0.43	0.043
0.43	0.043	0.44	0.044
0.44	0.044	0.45	0.045
0.45	0.045	0.46	0.046
0.46	0.046	0.47	0.047
0.47	0.047	0.48	0.048
0.48	0.048	0.49	0.049
0.49	0.049	0.50	0.050
0.50	0.050	0.51	0.051
0.51	0.051	0.52	0.052
0.52	0.052	0.53	0.053
0.53	0.053	0.54	0.054
0.54	0.054	0.55	0.055
0.55	0.055	0.56	0.056
0.56	0.056	0.57	0.057
0.57	0.057	0.58	0.058
0.58	0.058	0.59	0.059
0.59	0.059	0.60	0.060
0.60	0.060	0.61	0.061
0.61	0.061	0.62	0.062
0.62	0.062	0.63	0.063
0.63	0.063	0.64	0.064
0.64	0.064	0.65	0.065
0.65	0.065	0.66	0.066
0.66	0.066	0.67	0.067
0.67	0.067	0.68	0.068
0.68	0.068	0.69	0.069
0.69	0.069	0.70	0.070
0.70	0.070	0.71	0.071
0.71	0.071	0.72	0.072
0.72	0.072	0.73	0.073
0.73	0.073	0.74	0.074
0.74	0.074	0.75	0.075
0.75	0.075	0.76	0.076
0.76	0.076	0.77	0.077
0.77	0.077	0.78	0.078
0.78	0.078	0.79	0.079
0.79	0.079	0.80	0.080
0.80	0.080	0.81	0.081
0.81	0.081	0.82	0.082
0.82	0.082	0.83	0.083
0.83	0.083	0.84	0.084
0.84	0.084	0.85	0.085
0.85	0.085	0.86	0.086
0.86	0.086	0.87	0.087
0.87	0.087	0.88	0.088
0.88	0.088	0.89	0.089
0.89	0.089	0.90	0.090
0.90	0.090	0.91	0.091
0.91	0.091	0.92	0.092
0.92	0.092	0.93	0.093
0.93	0.093	0.94	0.094
0.94	0.094	0.95	0.095
0.95	0.095	0.96	0.096
0.96	0.096	0.97	0.097
0.97	0.097	0.98	0.098
0.98	0.098	0.99	0.099
0.99	0.099	1.00	0.100



